No. 111 Original

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1991

STATE OF DELAWARE,

*Plaintiff*,

STATE OF TEXAS,

*Plaintiff-Intervenor*,

—v.—

STATE OF NEW YORK,

*Defendant*.

## MOTION FOR LEAVE TO FILE BRIEF OF *AMICI CURIAE* IN RESPONSE TO THE REPORT OF THE SPECIAL MASTER AND BRIEF OF *AMICI CURIAE*

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SECURITIES INDUSTRY ASSOCIATION
THE NEW YORK CLEARING HOUSE ASSOCIATION
AMERICAN BANKERS ASSOCIATION
THE DEPOSITORY TRUST COMPANY

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The Securities Industry Association ("SIA"), The New York Clearing House Association (the "Clearing House"), the American Bankers Association (the "ABA"), and The Depository Trust Company ("DTC") hereby respectfully move, pursuant to Rule 37 of this Court, for leave to file the

annexed brief in response to the Report of the Special Master. The consent to the filing of the brief has been obtained from 37 states[1] and the District of Columbia. The consent of the states of Arizona, Colorado, Connecticut, Idaho, Minnesota, New Mexico, North Carolina, Oregon, South Carolina, Tennessee, Texas, Virginia, and Wisconsin has been requested and refused.

The *Amici Curiae* represent the entire spectrum of financial institutions in the United States.

SIA is the principal trade association of the securities industry, having as its members over 600 securities brokers and dealers. Its members range from internationally based, diversified financial institutions to small brokerage firms having only a handful of employees.

The Clearing House is an association of 12 leading commercial banks in the City of New York.[2] Its members offer asset management, private banking, trust, custody, and other securities processing services to customers; they hold

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[1] They are: Alabama, Alaska, Arkansas, California, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Utah, Vermont, Washington, West Virginia, and Wyoming.

[2] The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Bankers Trust Company, Marine Midland Bank, N.A., United States Trust Company of New York, National Westminster Bank USA, European American Bank, and Republic National Bank of New York.

in trust or custody accounts in excess of $5.4 trillion in securities.

The ABA is a national trade association that represents banks of all sizes and types throughout the United States. The assets of its membership represent approximately 90 percent of the banking industry total. Approximately 97 percent of ABA members are community banks with assets of less than $500 million.

DTC is a limited purpose trust company owned by participating broker-dealers, banks, and other financial institutions and is a national clearinghouse for the settlement of transactions in corporate and municipal securities. DTC is the largest securities depository in the world and maintains custody of $5.7 trillion in securities.

Members of *Amici* trade associations and DTC regularly receive dividend and interest distributions as the record owner of securities that are held on behalf of customers and others with whom they do business, including, in the case of DTC, its participants and their customers. As a result of their role as primary participants in the financial services industry in this country, members of *Amici* trade associations and DTC frequently hold funds that are received as dividend and interest payments on securities ("distributions") for which they are the record owner and for which neither the name nor the last known address of a beneficial owner can be determined. Even though only a tiny fraction of distributions go astray, and the individual amounts are relatively small, the number of such unclaimed distributions and the aggregate dollar amounts are enormous. In the past, financial institutions, as holders of unclaimed distributions, have routinely been obligated to comply with the abandoned property laws of the various states and have incorporated such requirements into their systems for processing distributions on securities.

*Amici* have a substantial common interest in the resolution of this controversy: if the Special Master's Report is adopted, it will have an immediate, adverse impact upon their future reporting obligations, as well as upon their day-to-day operations in processing distributions on securities. In addition, if the Report were adopted on a retroactive basis, financial institutions could find themselves subjected to a barrage of state audits, claims for unclaimed distributions received in the distant past, and potential claims for interest and penalties for failure to comply with the escheat laws of many states, which laws by their very terms did not in the past and do not now apply to these financial institutions.

In this regard, the Court should be aware that certain financial institutions participated in discovery proceedings in this action relating to the manner in which distributions are processed in the securities industry. That discovery was not directed to the difficulty or cost of compliance with an issuer-based rule for escheat of distributions as proposed in the Report; nor were *Amici* even aware of the proceedings before the Special Master that addressed the issue of retroactivity and the use of the locating principle of principal executive offices.[3] Thus, *Amici*, who represent the group to be most affected by the Report, have never before had the opportunity to address the issues raised by that Report.

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[3] Availability of the papers filed in that round of briefing was confined to the parties by direction of the Special Master.

WHEREFORE, *Amici* respectfully move this Court that leave be granted to file the annexed brief of *Amici Curiae.*

Dated: May 26, 1992

Respectfully submitted,

/s/ Judith Welcom

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The New York Clearing House Association

American Bankers Association

The Depository Trust Company

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## BRIEF OF *AMICI CURIAE* IN RESPONSE TO THE REPORT OF THE SPECIAL MASTER

The Securities Industry Association ("SIA"), The New York Clearing House Association (the "Clearing House"), the American Bankers Association (the "ABA"), and The Depository Trust Company ("DTC") submit this brief as *Amici Curiae* in response to the Report of the Special Master.

## INTEREST OF *AMICI CURIAE*

The *Amici Curiae* represent the entire spectrum of financial institutions in the United States.

SIA is the principal trade association of the securities industry, having as its members over 600 securities brokers and dealers. Its members range from internationally based, diversified financial institutions to small brokerage firms having only a handful of employees.

The Clearing House is an association of 12 leading commercial banks in the City of New York.[1] Its members offer asset management, private banking, trust, custody, and other securities processing services to customers; they hold in trust or custody accounts in excess of $5.4 trillion in securities.

The ABA is a national trade association that represents banks of all sizes and types throughout the United States. The assets of its membership represent approximately 90 percent of the banking industry total. Approximately 97 percent of ABA members are community banks with assets of less than $500 million.

DTC is a limited purpose trust company owned by participating broker-dealers, banks, and other financial institutions and is a national clearinghouse for the settlement of transactions in corporate and municipal securities. DTC is the largest securities depository in the world and maintains custody of $5.7 trillion in securities.

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[1] The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Bankers Trust Company, Marine Midland Bank, N.A., United States Trust Company of New York, National Westminster Bank USA, European American Bank, and Republic National Bank of New York.

Members of *Amici* trade associations and DTC carry on their books a substantial portion of the estimated one million different issues of securities outstanding in this country,[2] including corporate, municipal, and governmental debt obligations and equity securities. The issuers of these securities make distributions of interest and dividends through their paying agents to DTC, brokerage firms, banks, and other depositories, who are identified on the books of the issuers' transfer agents as record owners of the securities. While the financial institution may be listed as the record owner, the actual (or "beneficial") owner of the security may be someone else, usually a customer or contra party[3] of the financial institution or, in the case of DTC, one of its participants (or one of their customers). Members of *Amici* trade associations and DTC receive a substantial percentage of the total dollar amount of distributions made in this country annually. In 1991, DTC alone processed $267.4 billion of cash dividend and interest payments, based upon its holdings of approximately 75 percent of all outstanding corporate and municipal debt securities and equity securities.

As a result of their role as primary participants in the financial services industry in this country, members of *Amici*

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[2] *See, e.g.*, Deposition Transcript of John Cirrito of Prudential Securities Incorporated, at 18, 167 (records reflect approximately 300,000 different issues); DTC 1990 Annual Report (records reflect over 800,000 issues).

[3] The phrase "contra party" is used to mean a second financial institution that has, for example, purchased and taken physical delivery of securities from the record owner (or one of its customers). When a contra party fails to reregister the securities before the dividend or interest record date, the payment is sent by the issuer's paying agent to the record owner (who becomes a debtor to the contra party), even though the record owner no longer holds the securities and may be unable to forward the distribution to its creditor.

trade associations and DTC frequently hold funds that are received as dividend and interest payments on securities ("distributions") for which they are the record owner and for which neither the name nor the last known address of a beneficial owner can be determined. Even though only a tiny fraction of distributions go astray -- estimated to be only 0.02 percent (two ten-thousandths) of the entire amount distributed, Report of the Special Master (the "Report") at 10 n.9 -- and the individual amounts are relatively small, the number of such unclaimed distributions and the aggregate dollar amounts are enormous. In the past, financial institutions, as holders of unclaimed distributions, have routinely been obligated to comply with the abandoned property laws of the various states and have incorporated such requirements into their systems for processing distributions on securities.

Banks and brokerage firms have a substantial common interest in the resolution of this controversy: if the Report is adopted, it will have an immediate, adverse impact upon their future reporting obligations, as well as upon their day-to-day operations in processing distributions on securities. In addition, if the Report were adopted on a retroactive basis, financial institutions could find themselves subjected to a barrage of state audits, claims for unclaimed distributions received in the distant past, and potential claims for interest and penalties for failure to comply with the escheat laws of many states, which laws by their very terms did not in the past and do not now apply to these financial institutions.

In this regard, the Court should be aware that certain financial institutions participated in discovery proceedings in this action relating to the manner in which distributions are processed in the securities industry. That discovery was not directed to the difficulty or cost of compliance with an issuer-based rule for escheat of distributions as proposed in the

Report[4]; nor were *Amici* even aware of the proceedings before the Special Master that addressed the issue of retroactivity and the use of the locating principle of principal executive offices.[5] Thus, *Amici*, who represent the group to be most affected by the Report, have never before had the opportunity to address the issues raised by that Report.

## SUMMARY OF ARGUMENT

The Report concludes that an issuer of a security should continue to be considered a debtor, even after it has made payment of a distribution to the record owner of a security. This conclusion represents a marked departure from established tenets of commercial law, which recognize that an issuer's debt is discharged upon payment to the record owner, and it ignores the record owner's role as an agent of the beneficial owner, not the issuer. The Report substitutes a new, federal law of escheat for existing, state law principles. (Point I.)

The Court should not adopt the Report because it frustrates the goals of administrative ease and certainty that underlie existing escheat principles. The administrative burden that would result from the adoption of the Report and the uncertainty of any benefit to be gained by its adoption render the proposal inequitable. Moreover, the rules

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[4] While a representative of one broker-dealer did submit an affidavit at the request of the Alabama group of states in which he opined that compliance with an issuer-based rule would not be difficult (*see* Affidavit of John Happersett, dated January 3, 1991), members of the *Amici* trade associations and DTC disagree. *See* Point II, *infra*. Moreover, that affidavit addressed neither the use of principal executive offices as a locating principle for issuers nor the particular problems of retroactivity.

[5] Availability of the papers filed in that round of briefing was confined to the parties by direction of the Special Master.

proposed in the Report will impede the efforts of claimants, who are attempting to reclaim lost property, to locate it. (Point II.)

If the recommendations of the Report are adopted, they should not be given retroactive effect. Furthermore, financial institutions should only be required to report unknown-owner abandoned property to one state. They should be insulated from audits, claims, and demands for records. (Point III.)

## ARGUMENT

## POINT I

## THE SPECIAL MASTER'S REPORT REPRESENTS A COMPLETE BREAK WITH PRIOR PRECEDENTS.

### *A. The State Law Context of the Report*

The fundamental premise of the Report is that the significant relationship, for escheat law purposes, is the relationship between the issuer of a security and the ultimate beneficial owner of that security. The Report concludes that an issuer of a security should continue to be considered a debtor, even after it has made payment of a distribution to the record owner. This conclusion radically departs from established tenets of commercial law, ignores the realities of securities industry operations, and contradicts standard accounting principles. It does violence to the fundamental assumptions of commercial law that circumscribe and define debtor-creditor relationships for the specific purpose of ensuring certainty and finality, thus threatening to disengage escheat law principles from the other legal principles that govern the participants in the financial community.

For example, it is a longstanding principle of commercial law, codified in many states' corporation laws and recognized by caselaw and UCC Section 8-207 (adopted

in some form by all states), that an issuer may treat the record owner of a security as the person exclusively entitled to the rights of ownership. Thus, an issuer's debt is discharged upon payment of a dividend or interest distribution to the record owner (the creditor). Upon payment, the issuer ceases to be a debtor and it has no continuing obligation to the record owner. Instead, the financial institution that serves as the record owner, as recipient of the distribution, becomes, in turn, the debtor, and is obligated either to its customers, who may be the beneficial owners, or to another financial institution intermediary. The interactions between the issuer and the record owner, on the one hand, and the record owner and its creditor, on the other, constitute two discrete debtor-creditor relationships. If more than one financial institution intermediary is involved, then additional discrete debtor-creditor relationships also arise.[6]

Further evidence of this principle is found in other provisions of the Uniform Commercial Code that would apply in situations involving an issuer's payments of distributions by funds transfer or by check. For example, UCC Section 4-A-104 provides that a funds transfer is completed when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. As a general rule, the originator is discharged on any underlying obligation to the beneficiary at the time of acceptance pursuant to Section 4-A-406. Thus, when an issuer makes a payment of dividends or interest by funds transfer, the issuer would be the originator, the record owner would be the beneficiary, and the issuer would generally be discharged when the payment was accepted by the record owner's bank. Of

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[6] For example, DTC, as debtor, will make a payment to one of its financial institution participants, as record owner on DTC's books. That financial institution, as debtor, will make a payment to its customer, as record owner on the financial institution's books.

course, the ultimate beneficial owner *of the security* would not be the "beneficiary" for purposes of Article 4-A, unless he or she were also the record owner. Similarly, in the case of a distribution made by check to the record owner of the security or its agent, the issuer would be discharged on its underlying obligation upon presentment and payment of the check in accordance with Section 3-802(1)(b) of the UCC, irrespective of whether payment were ever received by the ultimate beneficial owner of the security.

These sections adopt, for various types of money transfers, the same principle that underlies the myriad transactions between participants in the securities industry: that payment to the creditor of record releases any obligation on the part of the payor, terminating its status as a debtor. This principle ensures that the rights and obligations associated with money transfers will be definite and clear. If, once a payment is made, the underlying obligation is discharged, the payor cannot be subject to duplicative liability, while the creditor knows against whom to assert a claim. The Report's recharacterization of the issuer of a security as a debtor after payment has been made to a record owner fabricates a debtor-creditor relationship between an issuer and beneficial owner that contradicts years of commercial law and violates the principles of certainty and finality. Moreover, any superficial appeal of this approach -- to the extent that it assumes that distributions go astray in the transaction between the issuer and the record owner -- evaporates in light of the many unclaimed distributions that arise in the subsequent interactions between financial institution intermediaries.

The universal recognition of the record owner as the debtor (after receipt of payment) is essential for orderly distributions of payments on securities. The Report seemingly concludes that for escheat law purposes, the transcendental relationship between an issuer and a potential

beneficial owner should take precedence over the state law objectives of certainty and finality upon which the UCC and similar laws are based. Escheatable items are only the unintended consequence of a series of transfers of money or securities that are governed by state law. Consequently, the imposition, under the guise of federal common law, of a conflicting and ambiguous rule based upon the indirect issuer/beneficial owner relationship threatens the coherence of the distribution process.

### *B. The Existing Jurisdictional Principles of Escheat Law*

This Court, in *Texas v. New Jersey*, 379 U.S. 674 (1965), stated that the question of which state is entitled to escheat unclaimed intangible property "should be settled once and for all by a clear rule which will govern all types of intangible obligations like these and to which all States may refer with confidence." *Id.* at 678. The Court went on to establish such rules -- rules that have been construed and relied on by financial institutions for over 25 years. The Court's rules established jurisdictional principles that instructed debtors where property was located for purposes of determining which state's escheat law to apply, not substantive requirements as to when and where to escheat the property.

In *Texas v. New Jersey*, the Court first held that "each item of property in question in this case is subject to escheat only by the state of the last known address of the creditor, as shown by the debtor's books and records." *Id.* at 681-82 (the "Primary Rule"). This rule was designed for clarity, fairness, and ease of administration. With respect to property owed to persons for whom there was no record of a last address, the Court concluded that the state of incorporation of the holder of the property (the debtor) has the power to escheat the property, subject to the right of another state to prove that the last known address of the creditor was in such state. *Id.* at 682 (the "Backup Rule").

In *Pennsylvania v. New York*, 407 U.S. 206 (1972), the Court adhered to the Backup Rule to ensure "ease of administration":

> [T]o vary the application of the *Texas* rule according to the adequacy of the debtor's records would require this Court to do precisely what we said should be avoided -- that is, "to decide each escheat case on the basis of its particular facts or to devise new rules of law to apply to ever-developing new categories of facts."

*Id.* at 215 (quoting *Texas v. New Jersey*, 379 U.S. at 679).

These jurisdictional rules relating to the situs of intangibles operate in conjunction with state abandoned property statutes, which adopt specific procedures for determining when property is considered abandoned and what should be done with it. The actual statutory provisions vary significantly from state to state. Indeed, many statutes have differing definitions of abandoned property and differing periods of dormancy, as well as differing reporting requirements, penalty provisions, and indemnification provisions. Despite these differences, however, state abandoned property statutes have consistently recognized that, with respect to securities, the record owners -- and not the issuers -- are the debtors under *Texas v. New Jersey*.

In this regard, one of the Report's central inferences in its deconstruction of *Texas v. New Jersey* is completely unfounded. The Report notes repeatedly that in *Texas v. New Jersey*, the Court did not mention the paying agent and transfer agent intermediaries of Sun Oil, who were the holders of some of the funds that were the subject of the litigation. *See* Report at 18 & n.15, 28, 32-34, 37. The Report infers from this that the Court considered such intermediaries insignificant and intended the term "debtor" to

refer to the originator of the funds rather than to any subsequent holder. This analysis assumes an analogy between the paying agent intermediaries in that case and the financial institution intermediaries that are the subject of the Report. In *Texas v. New Jersey*, the intermediaries were actually agents of the originator of the funds (the issuer), while here the financial institutions are agents of the beneficial owners. This distinction reflects long-established securities industry practice that should not be disturbed. The analogy is therefore flawed, and the point detracts from, rather than supports, the Report's conclusions.

Another example of the manner in which the Report introduces uncertainty into escheat law compliance by over-emphasizing the relationship between the issuer and the beneficial owner is in its treatment of the Primary Rule, which requires escheat to the state of the creditor's last known address. In note 55, the Report questions whether "it is appropriate to look to the next [financial institution] intermediary for purposes of the primary rule." Report at 63 n.55. Later, that implication is elaborated upon: "[I]n applying the primary rule, the last-known-addresses of the beneficial owners, not other intermediaries, will control." Report at 67. Thus, the Report seemingly recommends that the Primary Rule's "last known address" principle not be followed in situations where the apparent owner, based on the records of the holder, is a financial institution intermediary. This interpretive nuance again disrupts the automaticity of the escheat process.

Existing escheat laws and this Court's precedents have uniformly been understood to require a financial institution that holds abandoned property in its capacity as record owner to escheat such property to the state of the last known address of the creditor (whether an individual or a financial institution), as shown by the books and records of the financial institution. When such address cannot be

determined, the financial institution is to escheat the property to the state of the financial institution's incorporation. Brokerage firms, banks, and depositories have generally abided by these rules as commonly interpreted.[7]

### *C. The Report's Creation of New Law*

The Report painstakingly deconstructs prior precedents to justify its claim to be merely a refinement of previous articulations of escheat principles. As discussed above, *Amici* believe that the Report radically changes existing law. Assuming that a new, different Backup Rule should be considered, principles of *stare decisis* to the contrary notwithstanding, the Report's recommendations should be rejected in any event.

In the 27 years since *Texas v. New Jersey*, many states have altered their abandoned property statutes in order to conform them to the rules announced in that decision. Those state statutes have not been drafted to require abandoned property to escheat to the state of the issuer of the security to which an unclaimed distribution relates.[8] Whereas the rules established in *Texas v. New Jersey* act as a jurisdictional

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[7] This lawsuit was originally precipitated by a dispute between New York and Delaware over New York's alleged non-compliance with the Backup Rule, an allegation that New York sought to rebut under the Primary Rule by claiming the existence of last known addresses in New York for the owners of the distributions held by broker-dealers incorporated in Delaware. While compliance questions and political concerns have affected the evolution of that controversy, there has never, in the history of New York's and Delaware's dealings with financial institutions, been any question as to the identity of the debtor.

[8] Except, of course, when the financial institution holder is acting as an agent of the *issuer, see, e.g.*, N.Y. Aband. Prop. Law Article V (McKinney 1991), or, very recently, in response to the pendency of this litigation.

directory, pointing holders of abandoned property to the correct state's abandoned property law, the Report seemingly establishes new, substantive escheat law that is completely independent of state law. It does this in two ways: first, by disengaging the definitions of "debtor" and "creditor" from their commonly understood meanings, and second, by formulating and imposing escheat law obligations that do not derive from any particular state statute. While the bias against judicial promulgation of federal common law may be less pronounced in actions between states, *see, e.g., Connecticut v. Massachusetts*, 282 U.S. 660, 669-71 (1931), there are important differences between this action and other inter-state disputes, because the primary purpose of the laws involved here is to govern the day-to-day obligations and conduct of private parties. If the Report is adopted, the uncertainty caused by its recommendations will inevitably generate unnecessary costs that can be avoided if this Court reaffirms the validity of the existing jurisdictional, rather than substantive, escheat principles.

## POINT II

## THE COURT SHOULD NOT ADOPT THE REPORT.

### *A. The Report's Recommendations Are Administratively Burdensome.*

The Court formulated the Backup Rule, designating the debtor's state of incorporation as the jurisdiction entitled to escheat the intangible property of creditors with unknown addresses, primarily because it was conducive to ease of administration. *Texas v. New Jersey*, 379 U.S. at 682. The starting point of an analysis of the Report's recommended Backup Rule must therefore be the degree of difficulty in implementing it. *Amici* submit that changing the Backup Rule to require escheat to the state of location (however determined) of the issuer, rather than to the state of

incorporation of the holder, will demand a substantial and unnecessary commitment of time and money on the part of the recipients of unclaimed distributions. As a result, the distribution of securities-related payments will become less efficient and more costly.

In the past, many financial institutions needed only to be familiar with the abandoned property statutes of their state of incorporation and a handful of other states, where property having a last known address might escheat under the Primary Rule. Certain parties to this proceeding have argued that brokerage firms have routinely reported abandoned property to all of the claiming states and, therefore, the burden of compliance with the Report's recommendations would be insignificant. This contention is misplaced on several grounds.

First, while large brokerage firms having clients throughout the country report abandoned customer accounts (pursuant to the Primary Rule) to the states of the customers' last known address, because the account records for the lost customers contain an address, it is relatively easy to determine which state's law to examine and little interpretive effort is necessary.[9] Regional and small brokerage firms are in an entirely different position from the large wire house firms that have a national customer base; such firms have, in many instances, been able to confine their abandoned property compliance to a few contiguous states where they have customers. The level of increased burden on the smaller firms cannot be ignored -- SIA has over 600 members, of which only a dozen or so are household names throughout the country having customers in most of the 50 states. Similarly, banking institutions of all sizes, whose

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[9] *Amici* disagree with the Report's suggestion, at 39 n.36, that it is easier to report unclaimed distributions to all 50 states than to report abandoned customer accounts to all 50 states.

customers may be more limited geographically for legal reasons, have routinely filed reports under the Primary Rule (for abandoned customer accounts) with only one state or a few in the past.

Second, the Backup Rule has required only that financial institutions turn over the contents of a suspense account annually to a single state without the need to analyze the thousands of items in that account. The Report would drastically change these practices, requiring even a small brokerage firm with a regional clientele or a banking institution to analyze the myriad small items contained in suspense accounts and to file reports on distributions with states where they have had no prior contact -- even in states where the courts would lack personal jurisdiction to enforce a claim against such a financial institution! While it is true that the contents of the suspense accounts are, for most financial institutions, stored in a computer database that is subject to examination and processing, that fact does not minimize the difficulty of escheating distributions to their state of "origination".

State of origination (whether the state of the issuer's corporate domicile *or* its principal executive offices) has never been a datum that has been recorded for the contents of these suspense accounts. Even if the firm has a different database (some firms have dozens or hundreds of different databases) that contains such information, that information would need to be accessed for each issuer represented in the suspense account,[10] subject to subsequent interpretive efforts

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[10] The Report seemingly assumes that each issue of securities is the subject of a separate suspense account. *Amici* question whether this is in fact the practice among financial institutions. Even if it could be the practice, it would result in an enormous proliferation of suspense accounts (leading to further potential errors) and would not eliminate the interpretive ambiguities of the Report.

if, for example, the particular issuer changed its location between the distribution date and the date the analysis is performed. In short, *Amici* disagree with the Report's conclusion that "[n]o substantial additional bookkeeping or computer activity would be required . . . ." Report at 39.

The reporting process contemplated by the Report would no longer be routine and mechanistic; instead, it would require monitoring by non-clerical personnel. Many states have different dormancy periods for unclaimed property and different deadlines throughout the calendar year when reports must be filed. It is therefore conceivable that each financial institution would be continuously reporting unclaimed property throughout the year. Furthermore, the format of unclaimed property reports and the information required by each format varies from state to state, creating even more complexity within each firm's reporting system. Moreover, financial institutions would be subject to audit by each of the claiming states, resulting in potentially conflicting claims, as well as the need to resolve the individual statutes' substantive conflicts with the Report that arise from the statutes' general recognition of the record owner or holder of the property as the debtor.

The Report's recommendation that the location of issuers (and holders) be determined based upon the location of their principal executive offices is equally unwieldy. Financial institutions do not maintain suspense account records that identify the location of issuers' principal executive offices. Therefore, they would need to substantially modify their recordkeeping systems if the Report is adopted. The new records would have to be maintained based upon the states of principal executive offices of the issuers of hundreds of thousands of issues, and such data would have to be linked to distributions on those issues. Assuming such a system could feasibly be created, it would be extremely expensive and difficult to implement. As corporate issuers change the

location of their principal executive offices, financial institutions would have to constantly update their data.

Financial institutions would also be forced to make *ad hoc* interpretations with respect to issuers that list more than one principal executive office or, for that matter, issuers whose principal executive offices change location between the date a distribution is received and the date it is deemed abandoned. While none of these problems may ultimately be insurmountable, each requires the intervention of a person to decide how to characterize the distribution in question and where to escheat it. This required human intervention may arguably be required at several stages in the life of each unclaimed distribution: when it is first identified, perhaps again later when it is about to be reported and escheated, or maybe again if the categorization (i.e., the location of the issuer) has changed in the interim.

The Report suggests by way of solution that it should not be difficult to obtain the location of the issuer's principal executive offices from filings with the Securities and Exchange Commission (the "SEC") or to implement a computer program identifying issuers and their principal executive offices.[11] These suggestions oversimplify an uncertain and complicated process. There are private database services that contain corporations' designations in SEC filings of their principal executive offices, but those

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[11] The Report also suggests that it would be relatively simple for financial institutions to identify and locate the issuer of each security by its CUSIP number. Although CUSIP numbers are sometimes used in reporting abandoned property, items are also reported without a CUSIP number or any other descriptive information -- indeed, not all securities have CUSIP numbers. Furthermore, CUSIP numbers do not contain any information regarding the principal executive offices of the issuer. Some firms do not even use CUSIP numbers for recordkeeping, preferring to use an internally assigned, proprietary number.

databases have reported conflicting information and also reveal that hundreds of companies change the location of their principal executive offices. *See* Affidavit of Jeffrey Bossert Clark submitted in support of the State of Delaware's Opening Brief on the Issues of Changing the Supreme Court's Backup Rule and the Retroactive Application of the Backup Rule. Moreover, many companies do not make SEC filings. While the principal executive offices of those companies may be obtainable from other standard databases, a comparison of such databases reveals that many companies list two or more states as the location of their principal executive offices. *See id.* The determination of the location of an issuer's principal executive offices is anything but certain. Whether, for any particular issuer, it is possible to come up with a location is not the point; the necessity of scrutinizing, researching, and interpreting the research for each of the items in the suspense accounts is the problem.

Thus, the concerns raised by the Report's recommendations are interpretive as well as ministerial: it is not simply a question of spending the (not insignificant) time and money to create (and constantly update) or acquire access to computer programs that will identify, for each of an estimated one million issues, the location of the issuers' principal executive offices. A simplified example of the life-cycle of a dividend payment destined for a client of a brokerage firm may illuminate the problem:

- Issuer declares dividend on common stock; its transfer agent prepares to pay all record owners of the common stock.
- Issuer's paying agent issues checks to all record owners (on payment date).
- Brokerage firm credits customers' accounts on payment date and sets up receivables to reflect expected payment from issuer.

- Brokerage firm receives check, which is, for one of a variety of reasons,[12] larger than the receivables previously established; excess funds are recorded in dividend suspense account.

- Unallocated dividend remains in brokerage firm suspense account along with thousands of other items (relating to different issues of securities) that were received during the same period until either (a) a claim for it is asserted, (b) it is applied to an appropriate receivable that has been identified after the initial allocation, or (c) the time for escheat has elapsed.

*Existing Rule:* When the period of dormancy of the escheat law of the brokerage firm's state of incorporation has elapsed, the remaining contents of the entire suspense account, which may or may not have CUSIP numbers attached to the entries, are printed out on a list and turned over to a single state.

*Proposed Rule:* At some date prior to when any state's period of dormancy has run, the dividend is analyzed and compared with an in-house or outside vendor's database to determine the issuers' state of principal executive offices. That situs is checked to determine if it has changed since the distribution was received. If so, a decision is made as to which of the two locations should be used. That state's period of dormancy is checked. That state may not have a provision relating to escheat of dividends on securities of issuers whose principal executive offices are in that state, raising a question as to which period of dormancy to use or, indeed, whether that item should be escheated to the *holder's* state of principal executive offices under the Report's

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[12] For a more extensive explanation of how these distributions are made, *see* Report Appendix B, at B-15 through B-19.

Secondary Backup Rule. If the decision is made to use the law of the state of the issuer's principal executive offices, and if that period of dormancy has not elapsed, the dividend is left in account for further analysis. When another review is made, again a situs is determined, checked to see if it is consistent with prior determinations, and, ultimately, the dividend is reported and turned over to some jurisdiction. This process is undertaken for each of the other line items in the suspense account -- numbering perhaps in the thousands or tens of thousands for each firm.

### *B. The Report's Recommendations Are Inequitable.*

The Report accords great significance to the concept of fairness -- using fairness as the "tie-breaker", Report at 35 -- in its creation of new escheat law, but fails to recognize some of the considerations that bear upon fairness. To the extent that fairness is a consideration, it should be considered with respect to the holders of the property as well as in relation to the claiming states. Brokerage firms, banks, and depositories have made a substantial commitment in compliance procedures and computer systems to ensure that beneficial owners are paid the distributions to which they are entitled. The distribution system -- comprising legal, accounting, and technological components -- is highly effective, in part because financial institutions generally credit their customers' accounts with distributions on the payment date, whether or not the financial institution has received payment of the distribution from the issuer. *See* Report at 62-63 & n.54.[13] As the Special Master recognized in his Report, "In a tribute to the efficiency of the distribution system, such payments indeed make their way through the system . . . without

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[13] Thus, as explicated in the discovery proceedings before the Master, the unclaimed distributions held by financial institutions are generally not attributable to the fact that a customer of that financial institution has not been paid its distribution. *See id.*

incident in the overwhelming percentage of instances." Report at 10.

The existence of unclaimed distributions is an unintended by-product of securities processing -- an irritant to the holders who attempt to develop error-free systems for processing distributions. The administrative burden of retooling the existing systems and adopting new compliance procedures that would be imposed upon financial institutions if the Report were adopted would be substantial. To the extent that financial institutions have no claim to the property that is subject to escheat, it is unfair to impose upon them such an increased level of effort and expense.[14]

The adoption of the issuer's principal executive offices as the new locating principle would compound the inequities in the Report's recommendations. While the Report characterizes this change as "minor", Report at 49, 56, it will in fact be outcome-determinative in most instances. The Report suggests that this change will reward the jurisdiction that created the benefit to the issuer of the security. Report at 35. *Amici* disagree for two reasons. First, the notion that benefits are created where the issuer is located is questionable. Second, a corporation's principal executive office is not necessarily its principal place of business, nor where its actual decisionmaking occurs. Rather, a corporation's choice of where to locate its principal executive offices may depend instead upon legal issues, prestige, income tax benefits, or the lifestyle preferences of top

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[14] Certain property that may be escheated actually belongs to the financial institution, which cannot prove its entitlement because it is economically infeasible to locate the necessary records. In such situations, the requirement that such holders escheat such property to many states rather than to one decreases the likelihood that some equitable agreement can be reached based upon the holder's good faith demonstration (using statistical sampling or some other means) that some percentage of the property is its own.

management. Thus, given the geometric increase in the burden of escheat law compliance occasioned by adoption of such a nebulous and uncertain rule, the illusoriness of the benefit to be obtained renders the proposal inappropriate and unfair.

### *C. The Report's Recommendations Defeat the Fundamental Purpose of Escheat Laws.*

It is a basic tenet of escheat law that unclaimed property should be placed where the owner can find it. Adoption of the Report, however, could result in the dispersal of a claimant's property around the country. Claimants whose property failed to qualify for escheat under the Primary Rule, because of the absence of a last known address on the holder's records, would therefore be left with the formidable task of determining where and how to assert their claims, and of doing so in multiple states, depending upon the number of different issuers involved. In contrast, under present escheat law, a claimant is able to retrieve all property from one state -- either the state of his or her last known address or the state of incorporation of the holder, i.e., the financial institution with whom he or she dealt. Adoption of the Report would frustrate claimants' efforts to obtain possession of their property and would therefore obstruct the fundamental purpose of escheat law.

Even more important, perhaps, is the manner in which the Report modifies the Primary Rule. Financial institutions may be required, in situations where they actually have a record of the identity of the owner of an unclaimed distribution, to decide whether such owner is a "beneficial owner" (requiring escheat under the Primary Rule) or an "intermediary" (requiring escheat under the Backup Rule) -- thus introducing a judgment call into what was formerly a mechanical exercise. This recharacterization of the Primary Rule may also require a potential claimant to intuit whether some financial institution intermediary may have

characterized the claimant as an intermediary or a beneficial owner before determining where to assert a claim for its property.

## POINT III

## IF THE COURT ADOPTS THE REPORT, IT SHOULD DO SO PROSPECTIVELY, AND FINANCIAL INSTITUTIONS SHOULD NOT BEAR AN ADDITIONAL ADMINISTRATIVE BURDEN.

### A. *If The Court Adopts The Report, It Should Do So Prospectively.*

*Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), adopted the standard for determining whether a decision will apply retroactively or prospectively. Whatever the ultimate effect upon the decision in *Chevron* of this Court's retroactivity opinions in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991), *Amici* submit that where, as here, the Court's role is to promulgate federal common law rules, as a matter of equity the *Chevron* analysis should inform the articulation of those rules and the manner in which they will bind the affected parties and non-parties.

In *Chevron*, the Supreme Court formulated the following analysis:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed. . . . Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose

> and effect, and whether retrospective operation will further or retard its operation." . . . Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

404 U.S. at 106-107 (citations omitted). As applied to this case, the *Chevron* analysis supports the nonretroactive application of any decision adopting the Report's recommendations.

Under the first prong of the *Chevron* analysis, the Report creates a new substantive law component to existing escheat jurisprudence. The jurisdictional rules of priority established in *Texas v. New Jersey* were founded upon commercial law concepts based upon state law relationships. The Report defines the debtor and creditor as a matter of federal law by some notion of fairness. The Report ignores the fact that in *Texas v. New Jersey*, 369 U.S. at 680, the Court did not equate fairness with rewarding jurisdictions of companies whose business activities arguably caused the intangible property to come into existence.

Moreover, the Report's proposed changes in escheat law do not predictably arise from prior precedent. The Report changes the fundamental assumption of escheat law principles by changing the universally accepted commercial law understanding of the term "debtor". While the Report examines the particular facts of prior precedents, and concludes that the ultimate outcome of those cases and the Report's recommendations in this one are consistent, this conclusion is rebutted by the prior interpretations of those

precedents by both states and private parties. Additionally, the Report's recommendation that the state of principal executive offices, rather than the state of incorporation, be used as the location of the issuer is self-evidently a complete change in existing escheat law and one that, given its rejection in prior precedents, could not have been foreseen.

Under the second prong of *Chevron*, the Court must determine whether the purpose of the law at issue mandates retroactive, rather than prospective, operation. In *Texas v. New Jersey*, the Court defined its goals in fashioning escheat principles as fairness and ease of administration. A retroactive application of a decision adopting the Report would further neither of these goals. *Amici* submit that it is indisputable that retroactive application of the Report would cause immense administrative burdens for financial institutions, who would necessarily be subjected, by the claiming states, to the arduous task of recreating old records. Each of the millions of items of unclaimed distributions would have to be traced to its original issuer, the location of whose principal executive office (either at the time the distribution became abandoned or, perhaps, at the time the distribution was paid) would have to be unearthed from old and incomplete records. No legal principle would be vindicated by forcing these consequences to ensue; nor is it a sufficient response to suggest that the burden is eliminated if the records do not exist, the question being the level of search for those records that is demanded by the claiming states.

Finally, the *Chevron* test requires consideration of the reliance interests of all affected by changes in the law. Financial institutions have relied upon the commonly accepted statement of the *Texas v. New Jersey* debtor-creditor rule and have built procedures for compliance therewith into their systems for processing securities distributions. If this Court adopts the Report's recommendations, no party will be

harmed by its nonretroactive application: both the states and financial institutions have interpreted the Court's precedents in the same way and have relied upon that interpretation in, respectively, their adoption of escheat laws and their compliance therewith. By contrast, retroactivity would greatly burden financial institutions, as they would be subjected to audits, demands for old records, and potential claims for interest and penalties from all of the claiming states. This process would require an extraordinary expenditure of resources and staffing, with no accompanying benefit.

### *B. Financial Institutions Should Not Bear An Additional Administrative Burden If The Report Is Adopted.*

Adoption of the Report as it stands would require financial institutions to report and escheat property to all of the competing states. Given that each state has a different abandoned property statute, financial institutions would have to familiarize themselves with the conflicting abandoned property laws and would have to comply with differing dormancy periods, filing deadlines, and procedures and formats for filing, as well as hosting auditors from the competing states. *Amici* submit that if this Court adopts the Report, whether prospectively or retroactively, financial institutions should only have to report unclaimed distributions where the addresses are unknown to one designated state.

In *Pennsylvania v. New York*, 407 U.S. 206, 215, the Court stated that states, not financial institutions, should bear the extra costs imposed by escheat rules: "We think that as a matter of fairness the claimant States, and not Western Union, should bear the cost of finding and recording the available addresses, and we shall remand to the Special Master for a hearing and recommendation as to the appropriate formula for distributing those costs." *Id.; see also* Report at 68. Here, an equitable solution to the problems of implementing the Report would allow financial

institutions to report unclaimed distributions to only one designated state (such as their state of incorporation), and require the states themselves to resolve their respective rights to the reported property thereafter. Certainly, each state has a greater interest in developing a complete list of issuers located (by whatever principle) within its borders than does any holder of unclaimed property.[15]

Moreover, if this Court adopts the Report, financial institutions should be insulated from audits and claims for records with respect to stale escheat claims. For years, financial institutions have relied on the common interpretation of the *Texas v. New Jersey* rule. It would therefore be inequitable for them now to be subjected to the immense task of tracing records for all securities distributions in the past years, for which all states would inevitably make demand. Having failed, until the institution of this lawsuit, to press escheat claims based upon the location of issuers of securities, the claiming states should not now be allowed to vindicate such stale claims at the expense of the holders.

## CONCLUSION

This Court should not adopt the Special Master's Report. The Report represents a complete break with precedent and its implementation would be administratively burdensome and inequitable, contrary to the established purposes of escheat law. If, however, the Court does adopt the Report, it should do so prospectively only, and in a manner that will put any

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[15] It has been suggested that holders of unclaimed property avail themselves of the services of one of the abandoned property clearinghouses that have sprung up over the last several years. Given the abundance of interpretive issues raised by the Report's recommendations, it is not clear that such a move would truly protect a holder from an audit or claim by a non-participating state. Moreover, *Amici* foresee that the clearinghouses would have to pass along the cost of complying with the new rules.

resulting burden on the states rather than on financial institutions such as those represented by the *Amici*.

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